

Internal Revenue Service

Department of the Treasury

District
Director

Person to Contact:

Telephone Number:

Refer Reply to:

Date:

APR 06 1995

CERTIFIED MAIL

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code and have determined that you do not qualify for exemption under that section. Our reasons for this conclusion and the facts on which it is based are explained below.

The evidence submitted indicates that your organization was incorporated [REDACTED], under the laws of [REDACTED]. This document states that "The purpose of the corporation is to assist financially troubled citizens and members of the public who have demonstrated an inability to meet their financial obligations in a timely manner by acting as a liaison between the creditors and the debtor in negotiating payment plans and/or debt relief arrangements. The corporation may also offer counseling, budgeting and other related services in an attempt to assist financially troubled citizens. The corporation's services will be free of charge to the individual citizens."

You further provide that "the corporation is intended to be a non-profit organization organized under section 501(c)(3) of the Internal Revenue Code." Adequate provision has been made for the distribution of your organization's assets in the event the corporation dissolves."

Your activities, as stated in your application, "will be to counsel citizens who are experiencing difficulty with paying their credit card bills in a timely manner."

Your application further states that "The service will be initiated in two ways. Credit card companies will refer their overdue account holders to the company [REDACTED]. The citizens will also be allowed to engage the company on their own behalf. The services provided include negotiation of extended payment terms, postponement of collection procedures, negotiation of settlement amounts and assistance to the citizens on how to structure and maintain a better credit rating by meeting their credit card obligations in a timely manner."

Income to your organization will come from fees earned from credit card agencies and banks. You also state that "The corporation will market itself by contacting credit card companies and banks for solicitation of referrals. Periodic newspaper ads will be run to solicit business from the general public."

[REDACTED]

Page 2.

Two year projected expenses for your organization include salary for your President, approximately \$[REDACTED] annually, advertising expenses, \$[REDACTED], bank charges, \$[REDACTED], Insurance, \$[REDACTED], Professional Fees, \$[REDACTED], Supplies, \$[REDACTED], telephone, \$[REDACTED] and Miscellaneous, \$[REDACTED].

The officers of your organization consist of [REDACTED], President and sole shareholder of the organization and [REDACTED], Director. It appears that these activities will be conducted from your founder's personal residence at [REDACTED].

Section 501(c)(3) of the Internal Revenue Code provides for exemption from Federal income tax for organizations which are organized and operated exclusively for charitable, religious, and education purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to qualify for exemption under section 501(c)(3), an organization must be both organized and operated exclusively for one or more exempt purposes. Failure to meet either the organizational or operational test will disqualify an organization from exemption under section 501(c)(3).

Section 1.501(c)(3)-1(b)(1) of the Income Tax Regulations specifies that an organization is organized for one or more exempt purposes, if its Articles of Incorporation limit the purposes of such organization to exempt purposes.

Section 1.501(c)(3)-1(b)(1)(iv) of the income tax regulations provide that an organization is not organized exclusively for exempt purposes, if, by the terms of its articles, its purposes are broader than the purposes specified in section 501(c)(3).

Section 1.501(c)(3)-1(b)(4) of the Regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal government, or to a State or local government, for a public purpose.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations states that an organization is not organized or operated for any purpose under section 501(c)(3), unless it serves a public rather than a private interest.

Thus to meet the requirements of this subparagraph, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family shareholders of the organization or persons controlled, directly or indirectly, by such private interests. Moreover, even though an organization may have exempt purposes, it will not be considered as operating exclusively for such purposes, if more than an insubstantial part of its activities serve private interests.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations states that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense. The term includes: relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening the burdens of government; and promotion of social welfare by organizations designed to accomplish any of the above purpose, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice or discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

In International Postgraduate Medical Foundation v. Commissioner, 56 TCM 1140, TC Memo 1989-36, the court considered the exempt status of an organization whose activities involved a for-profit commercial entity. The court stated that "When a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3), even it furthers other exempt purposes."

In Ralph H. Eaton Foundation v. Commissioner, 55-1, USTC, 248, the court determined that an organization that engaged in commercial sales activities and donated its profit to charitable organizations was not entitled to exemption under section 501(c)(3). The court stated that "while the second purpose of this organization was charitable, the first purpose clearly was not. Since the organization did not meet the organized and operated exclusively for charitable purpose requirement, it did not qualify for exemption under section 501(c)(3).

In Living Faith Inc. v. Commissioner, 91-2, U.S.T.C. (7th Cir. 1991), the court discussed the commerciality doctrine as it relates to organizations described in section 501(c)(3). The court reviewed certain factors that are used to determine if an organization is operated exclusively for charitable rather than commercial purposes. The factors are that:

1. The organization sells goods and services to the public;
2. The organization is in "direct competition" with other entities providing the same services;

3. The prices set by the organization are based on formulas within the industry rather than "below cost"
4. The organization utilizes promotional materials to enhance sales.
5. The organization advertises its services to the general public.
6. The organization's hours of operation are basically the same as similar for-profit entities
7. The organization does not utilize volunteers but pays salaries to officials and other personnel.
8. The organization does not solicit or receive charitable contributions.

In Consumer Credit Counselling Service of Alabama, Inc. v. U.S., 78-2, USTC, 9660, the court discusses the criteria needed for an organization to obtain exemption under section 501(c)(3). Consumer Credit Counselling Service (CCCS) is a nation-wide organization that operates two types of programs which further their exempt purposes. One program utilizes a speakers bureau, educational films and publications discussing budgeting, buying practices and sound use of consumer credit. This information is widely distributed to all segments of the general public. A second program provides counseling to individuals and families on budgeting and debt management. No charge is made for these services.

The CCCS program also provides a debt management service as part of its overall educational program. Under this plan, CCCS intervenes with the clients' creditors to set up a debt reduction plan with commercial, retail and other businesses on behalf of the CCCS participant. Approximately 12% of CCCS's time is devoted to this debt reduction activity.

Funding for CCCS is provided by government grants, foundations, contributions from labor unions and agencies such as United Way. The Board of Directors for each CCCS agency has at least 60% representation from the general public. No agency is controlled by or financially supported by a commercial retailer, creditor or credit granting agency. Under the circumstances described, the courts have held this organization is operated exclusively for charitable and educational purposes and exempt under section 501(c)(3).

In B.S.W. Group, Inc. v. Commissioner, 10 USTC, 352-361, the court discusses the criteria used to determine if an organization is exempt or is operated like a commercial trade or business. Factors such as the manner in which the activities are conducted, the commercial due of the activities and evidence that an organization is in competition with commercial firms is strong evidence of a non-exempt business or commercial purpose. The courts have also held that when an organization's sole activity is similar to one conducted by a trade or business, its primary purpose are not charitable and educational but commercial, Golden Rule Church Association, 41 T.C. 728-729.

In Better Business Bureau v. United States, 326 U.S. 279-283, (1945), the court held that the existence of a single non-exempt purpose, if substantial in nature, will destroy exemption under section 501(c)(3) regardless of the number or importance of truly exempt purposes. To qualify for exemption under section 501(c)(3), the applicant organization must show (1) that it is organized and operated exclusively for religious, or charitable purpose, (2) that no part of the net earnings inures to the benefit of a private individual or shareholder, and (3) that no substantial part of its activities consists of the dissemination of propaganda or otherwise attempting to influence legislation or engaging in political activity. See Kenner v. Commissioner, 318 F. 2d. 632. (7th Cir. 1963).

Our review of the application submitted indicates that your articles of incorporation do not limit your purposes exclusively to one permitted by section 501(c)(3). This document states "the corporation is intended to be a non-profit organization organized under section 501(c)(3) of the Internal Revenue Code." An organization organized on a non-profit basis does not necessarily mean that it qualifies for tax exempt status under section 501(c)(3). This section provides that only organizations that are organized for religious, charitable, educational, literary, fostering national or international sports competition, and prevention for cruelty to children or animals qualify for exemption under this section. The fact that your organization is organized on a non-profit basis indicates that your purposes are broader than those permitted by section 501(c)(3). Therefore, as presently organized, your articles of incorporation do not meet the organizational test required to be exempt under section 501(c)(3).

From the description of your proposed activities, it is clear that your organization does not meet the operational test required for exemption under section 501(c)(3). You state that your primary activity will be to "counsel citizens who are experiencing difficulty paying their credit card bills in a timely manner." You expect to operate your organization in conjunction with commercial credit card companies and banks who will refer their overdue accounts to your organization for assistance. You also state that you expect to periodically advertise in the local newspapers to solicit business from the general public.

In addition, like the organization described in Living Faith, Inc., the following facts contained in your application indicate that your proposed operations are not exclusively charitable and educational, but commercial.

1. The services to be offered by your organization are in direct competition with both non-profit and for-profit credit counselling and credit repair services operating within your immediate area.
2. Your plans to advertise for business with the general public indicate that you serve a commercial rather than exclusively charitable or educational purpose.
3. Your proposed hours of operation are basically the same as similar for-profit entities providing these services.
4. Your organization does not plan to use volunteers to run your programs and expects to receive financial support from fees collected from commercial credit card companies and banks rather than by solicitation of contributions from charitable organizations, and the general public.

Your proposed operations are also like those described in International Postgraduate Medical Foundation. The assistance you provide to individuals to improve their credit reports provides substantial benefit to the commercial credit card companies and banks by improving their collection of delinquent debts and thereby raising their profit margins. Although your organization claims to be a non-profit entity, by entering into this type of arrangement you are operating for a substantial non-exempt purpose which defeats exemption under section 501(c)(3). As the courts stated in this case, "When a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code even if it furthers other exempt purposes." In addition, the courts have further stated that "when an organization's sole activity is similar to one conducted by a trade or business, the primary purposes of the organization are not charitable or educational, but commercial." Golden Rule Church Association, 41 T/C. 728-729.

The counselling services provided by Consumer Credit Counselling Service are distinguishable from your organization since the majority of their program is educational in nature and benefits the public at large. The debt management program consumes only 12% of their total program. CCCS is also financially supported from contributions from the general public and governmental agencies and is not dependent upon fees collected from commercial credit companies and banks.

You also indicate in your application that your organization is operated by [REDACTED] related directors who will work out of their private residence. Unlike the arrangement described in Consumer Credit Counselling of Alabama, Inc., where 60% of the board of directors were members of the local community, your board of directors consists of [REDACTED] related individuals who maintain complete control over your organization's operations and finances.

[REDACTED]

Page 7.

The courts have ruled that this type of arrangement creates a strong potential for abuse if tax exempt status is granted and serves the private interests of the founders and creators rather than required public purposes.

Based on the evidence submitted, we have determined that you do not meet the organizational test required for exemption under section 501(c)(3) since your purposes are broader than those permitted by this section.

You also fail the operational test since your proposed operations are similar to those conducted by a trade or business. Your proposed method of operation indicates that for-profit entities including banks and credit card companies will benefit substantially from your activities. Your plans to accept fees from commercial concerns for your services and to advertise your services to the general public indicates that your proposed operations are not exclusively charitable or educational, but commercial.

In addition, the fact that your board of directors consists of [REDACTED] related individuals rather than a board composed of members from the community indicates that your activities serve private rather than exclusively public purposes. The manner in which you expect to finance your operations by accepting fees from for-profit entities indicates that the net earnings of your organization inures to the benefit of your creators and founders which precludes exemption under section 501(c)(3).

Therefore, we have concluded that your organization does not qualify for exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code. In accordance with this determination, you are required to file Federal income tax returns on Form 1120.

Contributions to your organization are not deductible by donors under section 170(c)(2) of the Code.

In accordance with the provisions of section 6104(c) of the Code, a copy of this letter will be sent to the appropriate State officials.

If you do not agree with our determination, you may request consideration of this matter by the office of Regional Director of Appeals. To do this, you should file a written appeal as explained in the enclosed Publication 892. Your appeal should give the facts, law, and any other information to support your position. If you want a hearing, please request it when you file your appeal and you will be contacted to arrange a date. The hearing may be held at the regional office, or, if your request, at any mutually convenient district office. If you will be represented by someone who is not one of your principal officers, that person will need to file a power of attorney or tax information authorization with us.


Page 8.

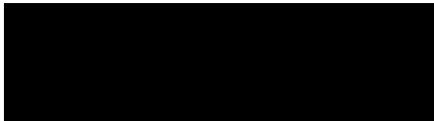
If you don't appeal this determination within 30 days from the date of this letter, as explained in Publication 892, this letter will become our final determination in this matter. Further, if you do not appeal this determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust administrative remedies.

Section 7428(b)(2) of the code provides, in part, that "A declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Appeals submitted which do not contain all the documentation required by Publication 892 will be returned for completion.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,


District Director

Enclosure: Publication 892

cc: 